

**NCUA Chairman Debbie Matz**  
**Speaking to American Association of Credit Union Leagues**  
**Naples, Florida**  
**November 13, 2009**

Thank you, Rosie. I've always enjoyed working with you, in your many roles. Rosie has led AACUL through some tumultuous times, and her "day job" as President of the Missouri League has given us all a chance to see her vision, her smarts and her stick-to-itiveness on a daily basis.

It's great to be back with you today in my new capacity as chair of the NCUA board. When I received a call from the White House personnel office, and the caller told me that the President wanted to know if I'd be interested in going back to NCUA as Chair, I didn't hesitate before saying yes. I said yes because I so enjoyed working at NCUA, but also because I believe credit unions are second to none in providing affordable, quality member service.

So even though my new role has me dispensing some tough love, I hope you remember that love is in fact part of it.

Between 2005 when I left the Board and today, the economic landscape in which we operate -- and the challenges we face -- have changed dramatically.

When I think about where we stand today, maybe because we're in Naples, I think about the famous story about the golfer, Lee Trevino. Lee was once asked what you should do if you're caught on the golf course in a thunderstorm.

Lee said, "Go stand in the middle of the fairway and hold up a one iron. Not even God can hit a one iron."

My point is this: We're in the middle of an economic storm, so we shouldn't be tempting fate with unnecessary risk.

I feel confident that we have not seen the worst of the storm. And we're just starting to see the full extent of the damage.

Over the last 14 months, NCUA has spent an inordinate amount of time stabilizing the corporate system. After more than six months overseeing the day-to-day operations of the two largest corporates, we have determined that the losses reported by those corporates must be recognized. That means, by the end of this month, U.S. Central's losses will have to be written off the books of all of their corporate members.

Last week I convened a meeting in our office so that the NCUA staff and representatives of corporates could get together and discuss this issue face-to-face. NCUA staff demonstrated that this is not mean-spirited or arbitrary; but we must follow Generally

Accepted Accounting Principles. Corporates came up with some good ideas to potentially address the issue of capital depletion in ways that could preserve capital holders' right to recovery if losses from legacy assets amount to less than auditors' current projections.

As a result of this meeting, NCUA staff is following up with corporate representatives in an effort to design an alternative approach to deal with the legacy assets in a way that will meet the rigorous accounting standards. I can't promise anything right now, but hope to have more information about that for you at another time.

As some of you may remember, I cast the lone vote against the corporate credit union rule when it was revised in 2002. As a new member of the board at the time, this was a difficult decision. I did not believe the crucial issue of risk concentration was adequately addressed. I also believed that the investment authority being granted was overly broad and permissive, particularly in light of the complexity of the financial instruments that were available to the corporates.

I bring this up not to say "I told you so" – but to underscore how important it is that we never again allow a handful of institutions to threaten the safety and soundness of the entire credit union system.

NCUA will tackle this challenge head-on, with a proposed corporate rule intended to strengthen the entire corporate regulatory framework.

Our proposed rule will be out for comment next week.

We will be proposing changes in four key areas:

### **1. Investment Authority**

The main culprit in the corporate credit union crisis was over-concentration in one type of investment.

So the proposed rule will set forth specific concentration limits by sector.

### **2. Capital Standards**

The global financial community has come to appreciate the importance of effective capital standards for financial institutions. This lesson certainly applies to corporate credit unions, which went into this crisis thinly capitalized relative to their balance sheets.

Recognizing this, the proposed rule would modify corporate capital requirements to make them more consistent with Basel I capital requirements. And for the first time there would be Prompt Corrective Action provisions similar to those that we currently apply to all other federally insured financial institutions.

### **3. Asset-Liability Management (ALM)**

NCUA's current corporate rule does not require matching of asset and liability cash flows. Because of this, severe liquidity stresses on the corporate system developed.

The proposed rule would establish new limits on cash flow mismatches to ensure that the gap between the average life of assets and liabilities does not present excessive risk.

### **4. Corporate Governance**

Presently, the corporate rule does not place any experience or knowledge requirements on individual corporate directors. As we have seen, this can lead to governance problems.

We will be proposing that all corporate board members hold a CEO, CFO, or COO position at their credit union or other member entity. This seems to be the best proxy available for experience, expertise, and appropriate motivation. We welcome your comments, of course.

To improve transparency, the proposed rule would also require that corporates annually disclose the compensation of each senior executive officer.

Also, the proposed rule would prohibit golden parachutes. We need to ensure that managers' incentives are aligned with their corporates' long-term interest, not their own self-interest.

Overall, you will find that the rule is not prescriptive – either in terms of the number of corporates that should exist, their location or the services they will offer. Ultimately, natural person credit unions have to make these decisions.

I look forward to your comments and suggestions on the proposed rule. The comment period will last 90 days.

I'm also going to be holding two town meetings during the comment period: January in Dallas and February in Orlando. And I plan to host a webinar later in February to reach those who cannot attend a town meeting.

I expect a final rule by mid-2010.

What else do we expect to see in 2010? Well, to put it in terms of movies you may have seen: We don't expect to see *Apocalypse Now* – but we do expect to see *Deep Impact*.

2010 will be a year of uncertainty and challenge. In part, that's because the capital written off by corporates will trickle down as losses to natural person credit unions.

It's also because natural person credit unions have their own challenges, independent of the corporates.

Capital stands at just over 10%, which is good, but it is a significant decline from 11.8% a year ago. While 98% of the 7,700 federally insured credit unions are still at least adequately capitalized, many credit unions will be draining capital further due to negative earnings.

Twenty-three credit unions failed in the first 10 months of this year, compared to 18 in all of 2008. Failures will likely rise again in 2010.

Most troubling is the growing number and size of credit unions which have been downgraded to CAMEL 4 and 5. Since the end of last year, the assets of credit unions in these troubled categories have almost doubled. The 326 problem credit unions are holding shares of \$36.5 billion – representing over 5% of all insured shares. That's the most shares at risk in more than a decade.

And there are more storm clouds on the horizon.

The number and assets of credit unions downgraded to CAMEL 3 have also nearly doubled. If we don't take corrective action now, today's CAMEL 3 credit unions may become tomorrow's CAMEL 4s and 5s.

Even the good news carries the seeds of potentially bad news within it: For example, credit union lending has increased by almost 8% since 2007. But at the same time, delinquencies and loan losses have increased, particularly in real estate lending. Real estate loan delinquencies are 1.6% -- more than 5 times higher than year-end 2007.

Given the high and increasing delinquency rates and the continued stresses in real estate markets, there's going to be a lot of pressure on credit unions in the months ahead.

I assure you: NCUA is monitoring these trends very closely. And that is why our examiners are going to be taking a hard look at four key areas of risk:

- First, your members need to know that we're going to be looking at credit unions that hold fixed-rate long term mortgages on their books. Across our industry, 55% of the fixed-rate loans are sold. The problem is the ones that are unsold are concentrated in certain institutions. I know that the impulse of credit unions is to be close to their members, and that this improves the loan to share ratio... but it is a risk. When interest rates go up – notice I said “when, not “if” – those fixed-rate mortgages that are earning relatively high rates now could slip underwater. And then it would be too late to sell them.
- Second, we're going to be looking at indirect lending. Credit unions need to drive their own indirect lending relationships, not simply outsource their loan decisions to auto dealers or third-party vendors. That means your members really need to be doing their own due diligence, pulling the credit reports and practicing sound

underwriting. If it's done properly, this is a fine way to grow business. If not, it can be a fine way to steer credit unions into insolvency.

I have an unfortunate example of what I'm talking about. There was a credit union in the southwest that served primarily minority communities, and it got in over its head with an indirect auto lending program. A combination of inadequate due diligence, lack of monitoring of their third-party vendors, and extremely poor underwriting led to a situation where they ended up with over 1,000 repossessed vehicles on their lot.

In just 3 years, repossessed assets grew from \$160,000 to over \$6 million. As a result, that once-healthy credit union had to be purchased and assumed by another credit union.

By any reckoning, the situation at that credit union was unacceptable. My job is to make sure that it's un-repeatable.

NCUA is going to take every appropriate step to improve our supervision in this area. But remember: Credit unions have to do their part too. My goal is a meaningful partnership between the regulator and the regulated that will ensure a sound future for credit unions.

- Third, loan participations. So much of this industry is built on trust. We don't want to lose that. But when it comes to loan participation, that attitude needs to be modified a bit: Trust, but verify. These are the cases where a handshake isn't enough. Even if someone else claims to have done it, your member credit unions need to do their own due diligence.
- Fourth and finally, we're looking at member business lending. I support removing or increasing the cap on member business lending. It makes no sense to me that Congress would put an arbitrary cap on the percentage of assets your members can lend in this way. Still, we all need to recognize that commercial loans are risky. Member business loan delinquencies are higher than any other type of loans – including real estate loans. Worse yet, MBL delinquencies are rising much faster than delinquencies on all other loans. So, if we see credit unions that are not doing their own due diligence – particularly on loan participations – they can expect a visit from their examiner.

When you add it all up, our position towards supervisory oversight is that it's not about capital alone.

We've seen credit unions with strong capital – and then 18 months later, they're gone.

So, looking forward, the red flags will be high concentrations of fixed rate mortgages, and indirect loans or loan participations where credit unions are not doing their own due

diligence. Even if they are well capitalized – we won't wait 12-18 months. We'll send an examiner sooner.

And we will be stepping up public administrative actions to ensure compliance. This is an important message that I would like you to share with your credit unions.

Let them know that if a credit union has not addressed NCUA recommendations contained in a private Document of Resolution, examiners will likely up with a public Letter of Understanding and Agreement – or in more severe cases, a public Cease and Desist order.

We are doing this to save as many credit unions as possible. Our hope is that credit unions will comply, and that we will not have to wind up merging, conserving or liquidating them.

As I said earlier, tough times call for tough love.

That said, our examiners aren't going to play "gotcha." We want them to be partners. Our goal is to detect and resolve problems before they become insurmountable.

We need your help in letting credit unions know this is coming. This stepped-up administrative action should not come as a surprise.

1) Please – Help get the word out. What I'm hoping to begin with you here today is a new era of open communications. One of my goals as Chairman is for NCUA to be a regulator that listens and encourages exchanges of ideas with credit unions.

Leagues are well positioned to facilitate these exchanges. You already do an outstanding job sharing credit unions' concerns with regulators. I believe you could also play an important role sharing regulators' concerns with credit unions.

I've laid out a series of actions that NCUA will be undertaking. Please let your members know what's coming, and what they need to do.

2) Help with the compliance burden. I encourage you to provide more compliance training – especially on the four key areas of risk I mentioned earlier.

3) Due diligence, due diligence, due diligence. We need you to help reinforce to all of your members the importance of due diligence in all of their relationships with third parties. This is an area where an ounce of prevention is definitely worth a pound of cure.

Our interests are aligned here: The goal is to serve and protect credit union members. And the way to do that is to make sure the credit unions they belong to are safe and sound.

That's what I'll be doing. That's what I hope you'll be doing as well.

I know when you hear all of the changes we're undertaking, it can sound – and may even sometimes feel – burdensome.

But I believe these efforts are vital to strengthening the trust members and potential members have in credit unions.

I also believe this is an incredible moment of opportunity for credit unions.

As consumers look for financial institutions they can trust, we are seeing a “flight to quality.” Strong, transparent, well-run credit unions offer the best quality there is in the world of financial services.

That's why credit union deposits are up by over 13% through the third quarter.

Consumers continue to respond to the promise of credit unions. They're voting with their pocketbooks, and their feet. There are now 90 million credit union members. I hope we see, by the end of my term, credit unions serving 100 million members. It's a worthy goal – for credit unions and for consumers.

The actions NCUA will be taking under my leadership are intended to strengthen credit unions. The stronger credit unions are, the stronger their members are. And the stronger their members are, the stronger our nation will be.

That's an important mission. And I look forward to working with you to achieve it. Thank you.